

July 26, 2005

**BY ECFS**

Marlene H. Dortch, Secretary  
Federal Communications Commission  
445 Twelfth Street, S.W.  
Washington, D.C. 20554

**Re: *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from AT&T Corp., Transferor, to SBC Communications Inc., Transferee, WC Docket No 05-65***

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Dear Ms. Dortch:

On July 15, 2005, EarthLink, Inc (“EarthLink”) filed further comments on the Internet Backbone issue, claiming that SBC and AT&T (the “Applicants”) have not adequately addressed the “vertical integration” aspects of the proposed transaction. What EarthLink disregards, however, is that vertical integration cannot create competitive harm unless there is market power at least at one level. EarthLink concedes that AT&T does not have market power in the backbone market, and makes no argument that the merger would create such market power. Focusing on the downstream level, EarthLink attempts to confuse matters by referring to the number of SBC local telephone customers who may use dial-up Internet access, disregarding the fact that the great majority of them are customers of independent ISPs. There is no basis for a concern that SBC has market power at the ISP level. Thus, since the Applicants have demonstrated that both the backbone and ISP markets are and will remain vigorously competitive, EarthLink's vertical integration argument is a non-starter.

Before addressing the specific arguments advanced in EarthLink’s latest submission, Applicants believe it is appropriate to review the specific facts that remain undisputed despite the multiple submissions by EarthLink:

- The Internet Backbone Market is not concentrated today – a marked change from the Internet Backbone world at the time of the proposed *WorldCom/Sprint* transaction in 2000 – and is operating competitively.
- The addition of SBC’s Internet traffic to the traffic carried on AT&T’s Internet backbone will not give the Applicants, post-merger, a sufficient share of Internet traffic to engage in strategic behavior in the form of either global, or targeted, de-peering.
- The parallel acquisition of MCI by Verizon does not alter the competitive analysis, given that, post-merger, Verizon/MCI will remain as the fourth largest

Internet backbone, based on share of North American traffic, at below 10 percent of traffic carried.

EarthLink asserts that Applicants have failed to address the “vertical” issues it claims will arise from this transaction. Specifically, EarthLink asserts that SBC’s acquisition of a key input to ISP service (backbone transmission services) will give SBC, as a large ISP, the incentive and ability to harm its ISP rivals. As EarthLink acknowledges, however, its argument necessarily depends on the Applicants acquiring market power in the backbone market as a result of the merger, for it is the exercise of backbone market power that, ultimately, EarthLink identifies as the source of potential harm:

“Imposition of discriminatory conditions on other IBPs, such as requiring the payment of transit fees instead of peering, or degrading or denying interconnection and transmission, would make the services of those other IBPs either more expensive or less desirable, or both. That in turn would make the retail services of the providers that rely on those impacted IBPs more expensive or less desirable or both.”<sup>1</sup>

It is this very issue that Applicants have addressed in detail, and as to which the critical facts are not disputed: the IBP market will remain unconcentrated and competitive, and backbone customers will continue to have ample alternatives to defeat any attempt by SBC/AT&T to engage in anti-competitive conduct. Absent market power at the IBP level or at the ISP level, neither of which exists here, there can simply be no vertical effect, as the necessary preconditions are absent.<sup>2</sup>

#### **A. Dial-Up Internet Users Are Not Controlled by ILECs**

In an effort to make SBC “richer” in last mile assets, EarthLink for the first time has introduced into its arguments the notion that dial-up Internet customers should be considered as part of SBC’s ISP access base. As EarthLink states, SBC “controls the vast majority of end user analog lines in SBC territory.”<sup>3</sup> EarthLink then attempts to bolster the significance of narrowband customers by offering a VoIP hypothetical that characterizes all of SBC’s circuit switched voice customers as representing SBC’s “capacity to provide Internet connectivity.”<sup>4</sup> And in the ultimate sleight-of-hand, EarthLink concludes that “the number of Internet users served by a combination of BOC-provisioned DSL and BOC-provisioned dial-up facilities substantially exceeds the number of cable modem service subscribers.”<sup>5</sup>

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<sup>1</sup> EarthLink Submission, at 2-3. Applicants note that the Ex Parte filed by Broadwing and SAVVIS on July 19, 2005 does not raise any Internet backbone issues that would alter Applicants’ analysis, and therefore no separate response to that Ex Parte is being filed.

<sup>2</sup> See, e.g., Sunshine, “Vertical Merger Enforcement Policy” (April 5, 1995) <http://www.usdoj.gov/atr/public/speeches/2215.htm>.

<sup>3</sup> EarthLink Submission, at 2.

<sup>4</sup> *Id.* at 4.

<sup>5</sup> *Id.*

But SBC's circuit switched voice customers, to the extent that they still access the Internet via dial-up service, are controlled not by SBC, but by the major dial up ISPs, such as AOL and EarthLink.<sup>6</sup> That these dial-up customers access their ISPs over BOC-provisioned telephone lines has nothing to do with the competitive analysis of the merger.<sup>7</sup> While dial-up ISP customers may pay SBC for their circuit switched telephone service, they are paying someone else for their dial-up Internet access. Control over the telephone lines simply does not give an ILEC any advantage as a provider of dial-up ISP services, or any incentive to discriminate in favor of dial-up customers of other ISPs.<sup>8</sup> If SBC had the ability or incentive to discriminate against dial up ISPs, it – and other ILECs – no doubt would have acquired much larger shares of dial up customers than they did.

### **B. The Merger Does Not Alter the Ability or Incentive of the Applicants To Discriminate Against VoIP Calls**

EarthLink next offers a hypothetical involving SBC/AT&T using the Internet backbone to deny Cox's IBP – "Z" – access to SBC/AT&T's millions of circuit switched voice customers. But this hypothetical similarly fails to raise any merger-specific issues, and completely ignores the manner in which VoIP service is provisioned.

EarthLink claims that "because" of the control by SBC of supposedly more than 80% of the analog telephone lines in its territory, the merged SBC/AT&T could compel every IBP that carries VoIP traffic to pay for the right to exchange that traffic with the SBC/AT&T network. But the "because" fact is independent of the merger – SBC today, as the incumbent ILEC, already has whatever incentives and abilities may exist to degrade VoIP interconnection. The merger with AT&T adds nothing of relevance to that analysis because the discrimination concern is already a "last mile" issue, and not a "backbone" issue.<sup>9</sup> Thus, the one instance of a carrier discriminating against VoIP calls involved Madison River's efforts to block Vonage calls at the point of interconnection with Madison River's local network facilities, i.e., the point of hand-off to the PSTN. The FCC has demonstrated that it has the resources to deal swiftly and harshly, with such conduct.

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<sup>6</sup> AOL claims to have some 22.7 million dial up subscribers, and clearly dominates the provision of narrowband Internet access. Public Interest Statement, at 111. AOL, of course, is part of cable giant Time Warner, which also controls millions of broadband lines. EarthLink reports having 3.9 million dial up subscribers, with the number of premium subscribers increasing rapidly. EarthLink 2004 Form 10-K, at 3. SBC, in contrast, had less than 1 million dial up subscribers at the end of 2004, and the number of its dial-up subscribers has been steadily declining.

<sup>7</sup> The Commission has previously found, "there are a large number of firms providing Internet access services . . . and these markets are quite competitive today." *AT&T/TCI*, 14 FCC Rcd at 3206 ¶ 93 (quoted in the Applicants Public Interest Statement at 110). Further, SBC is required by Section 201 of the Telecommunications Act to permit such access to occur on reasonable and non-discriminatory terms.

<sup>8</sup> EarthLink Submission at 3-4 and notes 4, 6, 8 and 9.

<sup>9</sup> EarthLink appears to acknowledge this point when it refers to the cable companies' submission to the FCC on the importance of interconnection. Where it errs is claiming that the merger somehow multiplies the concern. EarthLink Submission, at 3-4. See Applicants' Joint Opposition at 81-82.

EarthLink claims that adding AT&T's backbone assets somehow multiplies the dangers posed by the last mile assets, but this claim is wrong for at least three reasons: (1) the vast majority of VoIP traffic is, and will for many years continue to be, delivered via the PSTN, and not via Internet Backbone-to-Internet Backbone transmissions; (2) to the extent VoIP traffic traverses an Internet backbone, the broadband provider of VoIP chooses which backbone it will use for traffic, and AT&T's Internet backbone is not a bottleneck through which competitive VoIP traffic must pass; and (3) SBC/AT&T and the hypothetical "Z" backbone would *both* suffer relative to other IBPs, thus making the targeted degradation attempt not profitable.

Applying these points to EarthLink's hypothetical confirms Applicants' position. If SBC/AT&T attempted to disconnect IBP "Z", EarthLink claims that Cox's VoIP customers would be cut off from SBC's 45 million circuit switched voice customers. That claim, however, is simply wrong on the facts, and further ignores the non-VoIP implications of the proposed conduct. First, Cox's VoIP customers would reach *all* of the SBC voice customers, because Cox's VoIP calls would be delivered via the PSTN, as to which this transaction has zero impact, and which is amply regulated today.<sup>10</sup> Even as VoIP calls begin to travel from backbone to backbone, the PSTN will continue for many years to provide a parallel routing path that will allow parties to bypass any attempt by Internet backbones at de-peering or discrimination. This alternative will enable an ISP, for example, to bypass an Internet Backbone connection, by placing the VoIP call onto the PSTN, either locally, or at the gateway near to the receiving caller, just as happens today.

Second, to the extent that VoIP calls are carried some distance via Internet Backbones before being handed off to the PSTN, it is the broadband VoIP provider – in EarthLink's hypothetical, Cox, who selects which backbone to use. If backbone "Z" is degraded, there are others that Cox can select, and AT&T is but one of a number of capable IBPs available to Cox for these purposes.

Third, SBC/AT&T's Internet customers – DSL, business DIA, and dial up customers – would find that they could not reach those portions of the Internet accessible via "Z", and thus the value of Applicants' services as an ISP would suffer, as would the value of Internet access to customers of "Z" who could not reach SBC or AT&T end users. While one may suffer more than the other, the key point as

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<sup>10</sup> Despite the terminology, virtually all VoIP calls today traverse the PSTN, because a scaleable technology does not yet exist to allow for the necessary routing to occur otherwise (e.g., to hand-off such calls as VoIP from backbone to backbone). These developments are underway, but there is no clear timetable for their completion. As a result, industry analysts agree that conversion of circuit-switched voice traffic to packet-switched Internet backbone traffic will occur over a very long timeframe: "From a carrier perspective – backbone to backbone, where everything in the core is VoIP – we are about 10 to 15 years out. . . . From a consumer perspective, using VoIP on a global basis, it's probably beyond 25 years." ECT News Network, "Virtela CEO Vab Goel on the Future of VoIP", April 28, 2004 (<http://www.ectnews.com/story/33553.html>). "TDM is not going away tomorrow. Six years ago, people were talking about the death of TDM but they are here to stay and will probably not fully go away in our lifetime." PHONE+, "Enabling End-to-End VoIP," Jonathan Collins, December, 2004 (<http://www.phoneplusmag.com/articles/4c1sound4.html>) (quoting R. Paul Singh, Vice President of Business Development for Veraz Networks Inc.)

Dr. Schwartz noted is that *both* SBC/AT&T and “Z” would suffer in comparison to the numerous other Tier 1 IBPs that suffered no degradation in service. It is precisely because all Internet users expect to be able to connect with all other Internet users that the VoIP scenario posed by EarthLink will not happen, as any attempt at such strategic behavior will disproportionately harm SBC/AT&T’s Internet access service relative to all non-degraded providers of Internet access. At the low levels of Internet Backbone traffic shares that will exist post merger, an attempt to degrade connectivity with other backbones simply is not a profitable strategy, as the Applicants have amply demonstrated time and again.

As a final point, EarthLink attempts to broaden its hypothetical from VoIP access to Internet access generally, claiming that de-peering conduct by a merged SBC/AT&T would deny other ISPs access to over half of all Internet customers.<sup>11</sup> But, as noted above, this conflates circuit switched voice customers with Internet customers – while circuit switched voice customers may be destinations for VoIP callers, they are not Internet customers unless they are (a) dial-up customers of an ISP, as to which SBC and AT&T alone, or in combination, have no semblance of market power, or (b) broadband customers, as to which the Applicants have provided uncontested data showing that over 83 % of all residential and small business broadband is in the hands of other broadband providers.<sup>12</sup> Thus, EarthLink’s attempt to generalize its flawed VoIP hypothetical is likewise flawed.

### **C. The Merger Will Not Create the Potential for Targeted De-Peering of IBPs**

As noted at the outset, EarthLink claims that the competitive harm flows from the Applicants’ ability and incentive to increase costs to rival IBPs. But the Applicants have already demonstrated that this transaction will not

- alter the number of Tier 1 IBPs, of which there are many today,
- give Applicants the incentive or ability to engage in global de-peering, or conduct approximating global de-peering, or
- give Applicants the ability or incentive to engage in targeted depeering.

EarthLink and Applicants agree that no major Internet Backbone controls large numbers of end users. EarthLink’s claim, however, that AT&T’s lack of incentive to discriminate derives from its lack of control over last mile facilities or customers dependent on them ignores the entire foundation of the prior IBP merger challenges – it was precisely because of the Department of Justice’s and the FCC’s concerns over the “control over end users” that the WorldCom-MCI and the proposed WorldCom-Sprint mergers were challenged on the issue of competitive harm in the provision of IBP services, even though neither company controlled any significant last-mile assets. The Applicants have thoroughly explored

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<sup>11</sup> EarthLink Submission, at 5 (“SBC/AT&T would have the network capacity to accommodate as new customers those customers that were no longer satisfied with being able to reach less than half of the people using the Internet in the U.S.”).

<sup>12</sup> Schwartz Reply Declaration, Table 4.

both the facts and economic theory of those prior mergers, and have shown why, on today's facts, no challenge is warranted.

EarthLink's last claim is that cable companies would not behave as suggested by Dr. Schwartz because of theoretical technical issues related to switching, and potential "public good" aspects of such a switch. As to these two points, Applicants have already amply documented in the record the relevant facts:

Peering today frequently occurs at neutral, hosted sites (such as Equinix), where it is easy, as a technical matter, to cross-connect from one IBP to another.

Cable companies, the largest providers of broadband, have ample motivation to move traffic away from SBC/AT&T if SBC/AT&T attempts to de-peer other backbones.

Cable company switching will not give rise to potential free-rider issues, as cable companies compete almost exclusively with ILECs for broadband customers, rather than with other cable companies.

## **Conclusion**

Nothing in EarthLink's latest submission alters the fundamental facts that this transaction will not alter either the ability or incentive of Applicants to engage in de-peering or other strategic behavior vis-à-vis other IBPs. EarthLink's entire claim of harm from vertical integration rests, ultimately, on the harm originating in the IBP market, and flowing down to the ISP market, the level at which EarthLink competes. Applicants have shown, however, that there is simply no harm that will arise upstream and therefore nothing to flow downstream.

Sincerely,

SBC Communications Inc.

AT&T Corp.

**/s/ Gary L. Phillips**

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